May 17, 1991

To Our Clients:

Executive Compensation

Institutional shareholders, particularly the public pension funds, are focusing on executive compensation and what they claim to be a lack of identity of interest between shareholders and corporate managers and directors. The popular press and the business media are featuring critical articles. As Institutional Shareholder Services says in its May "Issue Alert":

> A series of recent articles focuses on the same question that institutional investors are increasingly asking -- Is director and executive compensation out of control? More and more, the answer is "YES!"

The current proxy season has seen a direct attack on the compensation of the chief executive officer of a major corporation based on the poor earnings and stock market performance of the corporation. Several institutions have refused to vote for stock option plans that permit grants at less than market price on the date of the grant. Proxy resolutions attacking golden parachutes were proposed at a number of companies and attracted considerable support. The Securities and Exchange Commission is indicating willingness to expand the ability of shareholders to attack and restrict executive compensation through the proxy process.

With the press and proxy statement attention being paid to executive compensation, we can expect that it will draw increased attention from strike suits. This type of derivative lawsuit was frequent several decades ago, but paled in significance to the more lucrative disclosure, takeover and buyout litigation of the 70's and 80's.

To avoid proxy and strike suit challenges, companies should review executive compensation and initiate changes toward meeting the following objectives:

- A much greater proportion of executive compensation should be based on real long-term (five years) appreciation in the price of the stock of the corporation.

- Stock options should be granted at not less than market at the date of grant and stock option plans should not provide for grant at less than market.

- Directors fees should largely be paid in restricted stock with sufficient cash to pay taxes.

- Compensation should be adjusted in relation to performance of the corporation as well as the individual executive. Poor performance by the corporation should result in reduced overall executive compensation.

Unless we anticipate the concerns of institutional shareholders and their power to <u>force</u> changes, corporations will face more proxy challenges and derivative litigation. Now is the time to review these matters.

M. Lipton